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SUBJECT: SLEDDING UPHILL ... AND SLIDING BACK DOWN: THE  
PROGNOSIS FOR REFORM

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (C) When Parliament returns from recess to begin its spring session in February, debate will return inevitably to the Gyurcsany government's reform agenda. Although Prime Minister Gyurcsany has pledged "smooth and steady progress" and is reportedly preparing legislation on party financing and public procurement, observers predict that the MSzP will tolerate minor modifications of the tax structure but no major new initiatives. Indeed, the business community is increasingly concerned that the government will spend the proceeds from its revenue enhancement efforts on social programs designed to court voters in the run-up to the public referendum March 9. For its part, the public appears far from convinced that the question is how best to undertake reforms. For some, the question is whether reform is politically possible; for many others, whether reform is necessary.

UN-CHANGE AGENTS

¶2. (C) Few here are talking about better mousetraps - much less building them. Junior coalition partner SzDSz has unveiled a public campaign to drum up support for tuition and medical fees in preparation for a spring referendum, now scheduled for March 9. But the party's members argue privately - and often publicly - that the government has undermined the right idea with the wrong approach. Ferenc Juhasz, who will organize the MSzP's efforts to prepare for the referendum, has indicated that the party's hopes lie in a low turn-out.

¶3. (C) Although our own election campaign remains a source of great fascination, there is little competition here over the title of "change agent." The reflex of Gyurcsany's critics - within his own party and beyond - has been to reduce speed or to reverse direction entirely on reform. Party Praesidium member Attila Mesterhazy tells us that the party has circled the wagons around Gyurcsany, but made clear that "we do not want to start new reforms but to finish what we've already started." Although he indicated that "minor modifications" of the tax code are possible, he sees no immediate prospect of reducing the size of government or of taking on longer-term issues such as pension reform - issues they regard as well beyond the public's stress tolerance. Although we understand from industry reps that the government is preparing legislation on both party finance reform, public procurement, and public administration, Mesterhazy gave no indication that the party is ready for further steps.

DENIAL ON THE DANUBE

¶4. (C) Indeed, we are constantly struck by the extent to which contacts across the political spectrum remain in denial, ignoring the economic imperative of reform and focusing on the political priority of "solidarity." In

returning the government's Health Care reform legislation back to Parliament, President Solyom leveled a series of objections, among them that the plan could not be "guaranteed," as referred to in the Constitution.

15. (C) Even the PM's supporters privately concede that the referendum will likely succeed, and government spokespersons have alluded to "finding fees from other sources" to replace education and medical fees. While the referendum does not compel new elections, the opposition continues to cast it as a de facto vote of confidence in the Gyurcsany government, hoping to mobilize their own supporters and potentially motivate Gyurcsany's rivals within the MSzP. They are also moving toward a second referendum - this one on the government's health care reforms - later in the year.

#### MORE SENSE OF ENTITLEMENT THAN COMMON SENSE

16. (C) Gyurcsany's opponents increasingly open fire from the left on economic issues by casting his actions as attacks on Hungary's social compact. And with considerable effect. Among Hungary's aging population, nostalgia for the perceived security of the communist system is widespread and unease with free-market competition tangible. But even younger Hungarians can be remarkably hidebound, often regarding education, health care, and an expansive array of social services as not just free goods but free goods in infinite supply. Many assert "we already pay with our taxes" (itself a dubious claim given the extraordinary rates of tax evasion), and few see the connection between Hungary's bloated welfare apparatus and its anemic economic indicators. They are, as one student group leader admitted, "not against anything but the government." Even FIDESZ leader Viktor Orban, who has privately suggested that young voters will

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give his party "a permanent majority," laments that Hungary remains "a land of no responsibility and no consequences."

17. (C) For their part, reformers have done themselves few favors in practice. The Gyurcsany government's approach has left it vulnerable to questions of competence and to charges of corruption. The Prime Minister's personal wealth has reinforced the popular suspicion that behind every fortune there is indeed a crime. His management style - described by some even within the government as "indecision followed by imposition" - has compounded the problem, leading to legislation that one legal scholar describes as "always hurried and often flawed." This invites the public to equate reform with directives rather than genuine debate even as it undermines confidence in the government's fundamental competence. The government's public relations efforts have been consistently behind the curve in framing issues for voters, and their focus has often been on limiting damage rather than the even harder job of making its case. As Mesterhazy conceded, "the government has forgotten how to speak to the people."

#### "CONSIDER THE SOCIAL CONSEQUENCES ..."

18. (C) This leaves the government, in the words of one AmCham executive, with little public support as it "avoids one iceberg but steers toward another." With the success of deficit reduction coming largely at the expense of growth and competitiveness, Hungary risks lagging badly in the regional competition for foreign investment. In a long and often uncomfortable meeting January 21, representatives of the foreign business community warned Prime Minister Gyurcsany, Finance Minister Veres, Economy Minister Kakossy, and Development Minister Bajnai that the revenue from enhanced tax collection should be reinvested rather than redistributed to the public through new social benefits. That the meeting was over two years in the offing underscores the business community's frustration with a government that listens to their concerns rarely ... and responds even less frequently.

¶9. (C) According to corporate reps attending the meeting, Gyurcsany acknowledged their point but underscored the need to "consider the social consequences." The PM was similarly ambivalent at the WEF in Davos, reportedly conceding that Hungary's growth rate could dip below 1 percent in 2008 but maintaining that the country needs "no new austerity - only discipline." Our contacts left their meeting with the PM concerned that the government will feel the need to resume spending to win over the public as the March referendum approaches, risking the economic gains they have made to date in pursuit of uncertain political advantage.

COMMENT: DEATH OF A SALESMAN - AND A SALE?

¶10. (C) The Prime Minister's travails will make future reforms harder and may well make future reformers even harder to find. Gyurcsany's departure - which most here see as inevitable before the next elections - will likely clear the way for the MSzP to take a "great leap backward" on reform. Although the "Gyurcsany package" may prove too heavy a burden for the PM to carry, he alone has not given reform its bad name. Even if the MSzP grows further disposed to dispose of Gyurcsany, a change at the top is unlikely to represent a fresh start for reform. Quite to the contrary. Their "nothing new" strategy is nothing surprising, and the party may revert to form by prematurely spending the proceeds of its revenue enhancement. No matter who the salesman is, the concept will remain a hard sell with a Hungarian public that looks backward more easily than forward. Polling already shows that Parliament is now less than half as popular as the postal service: that may well give the future reforms Hungary needs less than half a chance. End Comment.

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